

Message Text

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C O N F I D E N T I A L SECTION 1 OF 2 MADRID 5983

E.O. 11652: GDS

TAGS: PFOR, ECON, EFIN, SP

SUBJECT: POLITICAL AND ECONOMIC VIEW OF BANK OF SPAIN GOVERNOR

1. SUMMARY: BANK OF SPAIN GOVERNOR, WHO MAY SOON BE REPLACED, HAS PROVIDED EMBOFFS HIS ANALYSIS OF POLITICAL AND ECONOMIC OUTLOOK TOGETHER WITH HIS PRESCRIPTION TO HELP CONTROL SERIOUS INFLATIONARY PROBLEM. INFLATION ORIGINALLY GOT OUT OF HAND, HE CLAIMED, AS RESULT OF GOS DECISION TO ABSORB 1974 OIL PRICE INCREASES BY FOREGOING TAXES ON PETROLEUM PRODUCTS FROM CAMPSA STATE MONOPLX, THUS PRODUCING SIGNIFICANT BUDGET DEFICITS. INFLATION HAS BEEN FUELED SINCE BY HIGH WASY SETTLEMENTS AND EXPANISION OF DEFICITS BECAUSE OF INCREASED SPENDING. BANK GOVERNOR WOULD PRESCRIBE MODERATE RESTRICTIVE MEASURES TO REDUCE GOVERNMENT SPENDING; TAX HEAVY POWER CONSUMPTION, LARGE AUTOMOBILES, AND LUXURIES; AND RESTRAIN WAGES. PRESENT GOVERNMENT, HE FEARS, UNLIKELY TO ADOPT MEANINGFUL STABILIZATION MEASURES BECAUSE OF POLITICAL CONCERNS OVER REFERENDUM AND ELECTIONS. IN FACT, IT IS PROBABLY BIASED TOWARD EXPANSION HE BELIEVES. AS A RESULT, IN HIS VIEW, GOVERNMENT COMING INTO POWER FOLLOWING SPRING ELECTIONS WILL

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PROBABLY BE FACED WITH A WORSENERD ECONOMIC SITUATION

REQUIRING MORE SEVERE MEASURES THAN THOSE REQUIRED NOW - MEASURES THAT COULD BE MORE POLITICALLY DIFFICULT AND DANGEROUS THAN NOW. END SUMMARY.

2. DURING LONG INTIMATE LUNCHEON CONVERSATION ON AUGUST 2, BANK OF SPAIN GOVERNOR CORONEL DE PALMA CONFIDED TO EMBOFFS CONTINUED UNCERTAINTY ABOUT HIS TENURE IN OFFICE AND EXTREME PESSIMISM ON THE COURSE OF THE ECONOMY AND THE IMPACT OF ECONOMIC PROBLEMS ON POLITICAL EVOLUTION OF SPAIN.

3. TALK ABOUT REPLACING HIM AS BANK GOVERNOR, HE SAID, STEMMED FROM WHAT HE CONSIDERED INNOCUOUS EXPRESSION OF PERSONAL VIEWS IN LINE WITH GOVERNMENT POLICY WHICH HE MADE TO PRESS AT CONCLUSION OF RECENT VISIT TO ISRAEL. HE HAD MERELY SAID, IN RESPONSE TO A QUERY, THAT LARGE PORTION OF SPANIARDS FAVOR RELATIONS WITH ISRAEL, GOS POLICY IS TO NORMALIZE RELATIONS WITH ALL COUNTRIES, AND THEREFORE, HE EXPECTED DIPLOMATIC RECOGNITION WOULD COME WITHOUT UNDUE DELAY. UPON HIS RETURN TO MADRID HE HEARD REPORTS OF PRIME MINISTER'S DISPLEASURE WITH HIS HAVING MADE FOREIGN POLICY STATEMENTS ABROAD AND OF PROTESTS BY ARAB GOVERNMENTS, BUT NO CABINET MINISTER HAS OBJECTED TO HIS STATEMENTS TO HIM PERSONALLY AND NO ONE HAS REQUESTED HIS RESIGNATION. HE THEREFORE CONTINUES TO DO HIS JOB, AND DOES NOT PLAN TO ASK QUESTIONS. HE ARGUES THAT REPORTED MOTIVATION FOR DISMISSAL IS INADEQUATE, BUT NEVERTHELESS GIVES THE IMPRESSION HE EXPECTS TO LEAVE AND RETURN TO PRIVATE BUSINESS.

4. CORONEL DE PALMA SAID MOST PRESSING ECONOMIC PROBLEM IS OBVIOUSLY INFLATION WITH CONSEQUENT EXACERBATED BALANCE OF PAYMENTS DEFICITS AND GROWING EXTERNAL DEBT. HE ATTRIBUTED BEGINNING OF PROBLEM TO MISTAKEN ESTIMATE OF FORMER FINANCE MINISTER BARRERA DE IRIMO THAT OIL CRISIS WOULD ONLY LAST TWO YEARS WITH SUBSEQUENT REDUCTION IN OIL PRICE. AS RESULT, GOS OPTED TO SUBSIDIZE LOW FUEL PRICES TO CONSUMER BY FOREGOING FUEL TAXES FROM CAMPSA STATE MONOPOLY, ASORBING DIFFERENCE WITH BUDGET DEFICITS AND RELYING ON HIGH RESERVES TO WEATHER STORM. CONFIDENTIAL

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NO ACTION WHATEVER HAD BEEN TAKEN TO RESTRICT ENERGY CONSUMPTION. MORE RECENTLY, HIGH WAGE SETTLEMENTS (WHICH HE ESTIMATED AT 40 PERCENT IN SOME CASES AND 30 PERCENT ON THE AVERAGE IF FRINGE BENEFITS CONSIDERED) AND INCREASED PUBLIC EXPENDITURES AND OFFICIAL CREDITS HAVE ADDED IMPETUS TO PRICE INCREASES. RESULT IS INFLATIONARY PSYCHOLOGY. HE CLAIMED THAT FORMER FINANCE MINISTER VILLAR MIR AGREED IN THE END TO SHARP EXPANSION OF GOVERNMENT SPENDING AND CREDITS TO ATTEMPT TO SAVE HIS JOB.

HE SAID THAT HE OPPOSED BARRERA DE IRIMO'S POLICY ON PETROLEUM PRICES, AND LATER TRIED TO CONVINCE JUAN CARLOS THAT IF FRANCO COULD NOT BE PERSUADED TO ACT THE BEST TIME FOR STABILIZATION MEASURES WAS IMMEDIATELY AFTER JUAN CARLOS BECAME KING, WHEN THE NEED COULD BE BLAMED ON THE PREVIOUS REGIME.

5. CORONEL DE PALMA SAID THAT SINCE THERE ARE OBVIOUSLY LIMITS TO CAPACITY TO FINANCE DEFICITS AND ACCUMULATE FOREIGN DEBT, AT LEAST MODERATE ANTI-INFLATIONARY MEASURES ARE REQUIRED TO CONTROL INFLATION AND ENCOURAGE SOME INVESTOR CONFIDENCE. HE WOULD PRESCRIBE MEASURES WHERE ALL WOULD SHARE BURDEN PROGRESSIVELY ACCORDING TO INCOME. HE WOULD RESTRAIN DEMAND BY SUCH MEASURES AS DISCIPLINE IN PUBLIC EXPENDITURES, PROGRESSIVE INCREASE IN ELECTRICITY RATES ACCORDING TO VOLUME CONSUMPTION, PROGRESSIVE TAXATION ON AUTOMOBILES ACCORDING TO HORSEPOWER, LUXURY CONSUMPTION TAXES, AND WAGE RESTRAINT IF POSSIBLE. HE WOULD ALLOW THE PESETA TO FLOAT DOWN TO MORE REALISTIC LEVEL FOR EXTERNAL EQUILIBRIUM. IN THIS REGARD, HE SAID THAT ALTHOUGH BOTH EXPORTS AND IMPORTS ARE RATHER IN-ELASTIC, CAPITAL FLIGHT CAN ONLY BE STOPPED BY EXCHANGE RATE MOVEMENT COUPLED WITH SOME STABILIZATION ACTION, UNLESS POLITICALLY IMPOSSIBLE MAJOR DEFALTIONARY ACTIONS WERE UNDERTAKEN.

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C O N F I D E N T I A L SECTION 2 OF 2 MADRID 5983

6. CORONEL DE PALMA FEARS THAT PRESENT GOVERNMENT, FACED WITH REFERENDUM AND SUBSEQUENT ELECTIONS, IS UNLIKELY TO TAKE ANY MEANINGFUL ACTION AND IS MORE LIKELY TO ADOPT LIMITED MEASURES, MOSTLY EXPANSIONARY. TOP LEADERS IN NEW GOVERNMENT, HE SAID, ARE YOUNG, AMBITIOUS, AND POLITICALLY MINDED WITH LITTLE EXPERIENCE IN ECONOMIC MATTERS. HE NOTED THE LACK OF INTEREST IN ECONOMIC ISSUES OF FORMER PRIME MINISTERS CARRERA BLANCO AND ARIAS NAVARRO, WHICH HAD, HE THOUGHT, CONTRIBUTED TO THE ADOPTION OF MISGUIDED, SHORTSIGHTED ECONOMIC POLICIES. HE DID GIVE SUAREZ CREDIT FOR PUTTING IN LONG HOURS TRYING TO FAMILIARIZE HIMSELF WITH ECONOMIC ISSUES. SOME CABINET HOLDOVERS, SUCH AS INDUSTRY MINISTER PEREZ DE BRICIO (WHO IS CLOSE TO KING), BELIEVE INFLATION IS A CONCEPTUAL ILLUSION AND FAVOR REACTIVATION THROUGH STIMULATION OF AGGREGATE DEMAND. THIS IS A DANGEROUSLY MYOPIC VIEW, ACCORDING TO CORONEL DE PALMA, BECAUSE PRESENT TRANSITIONAL CABINET IS REALLY IN BETTER POSITION THAN FUTURE ELECTED GOVERNMENT TO TAKE NECESSARY BUT UNPOPULAR STABILIZATION MEASURES. HE SAID THAT HE HAD PROVIDED THE NEW GOVERNMENT WITH A MEMORANDUM CONTAINING THE BANK OF SPAIN'S VIEWS. HE PRESUMED ENRIQUE FUENTES QUINTANA AND ANGEL ROJO, WHO WERE REALLY BANK OF SPAIN MEN, HAD PROVIDED SIMILAR VIEWS. WHEN ASKED, BUT HE WAS AFARID THE GOVERNMENT WOULD END UP LISTENING TO OTHER VOICES (HE MENTIONED JOSE RAMON CONFIDENTIAL

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LASUER) WHO HE SAID IS CLOSE TO VICE PRESIDENT OSORIO).

7. LOOKING TO FUTURE, CORONEL DE PALMA BELIEVES CENTER RIGHT GOVERNMENT WILL WIN ELECTIONS IN THE SPRING. PROBLEM IS THAT SUCH A GOVERNMENT WOULD INHERIT A LEGACY OF UNRESOLVED ECONOMIC PROBLEMS, CONSIDERABLY WORSE THAN THEY ARE NOW. NECESSARY STABILIZATION MEASURES FOLLOWING ELECTIONS WOULD TEND TO SPARK REACTION FROM LEFT WITH STRIKES AND CIVIL DISORDER PROVOKED BY COMMUNISTS MANIPULATING GENUINE ECONOMIC GRIEVANCES. HE FEARS SOMETHING AKIN NOT TO PORTUGAL, BUT TO ITALY TRANSPLANTED TO THE SOIL OF A MORE VIOLENT LAND. LATIN AMERICA HAS DEMONSTRATED, HE SAID, THAT THE DENOUEMENT OF GALLOPING INFLATION AND PROGRESSIVE DEVALUATIONS IS A MILITARY TAKEOVER.

8. COMMENT: CORONEL DE PALMA'S VISTA OF SPAIN,S FUTURE IS DISMAL INDEED. HE FREQUENTLY LAPSES INTO THE VOCABULAR OF THE BUNKER (E.G., THE SPANISH PRESS IN ALREADY TOO FREE, ALL SOCIALISTS ARE CRYPTO-COMMUNISTS, AND SPANIARDS ARE VIOLENT, POLITICALLY UNSOPHISTICATED PEOPLE PROBABLY UNABLE TO GOVERN THEMSELVES). NEVERTHELESS, HIS ANALYSIS OF ECONOMIC PROBLEMS AND HIS PRESCRIPTION OF MEASURES THAT WOULD BE HELPFUL ARE ON THE MARK. (SEE MADRID 5643 FOR EMBASSY ASSESSMENT.) THE SUAREZ GOVERNMENT IS GIVING SPECIAL ATTENTION NOW TO ECONOMIC ISSUES, WITH SUAREZ HIMSELF PERSONALLY CHAIRING THE DELIBERATIONS OF A CABINET COMMITTEE. ITS FIRST ECONOMIC ACTIONS IN

LA CORUNA ON JULY 30 WERE LIMITED, BUT EXPANSION-
ARY. IT EVIDENTLY HAS DECIDED AGAINST A DRAMATIC OVERALL PRO-
GRAM. WHAT THE OVERALL THRUST OF ITS STEP-BY-STEP ACTIONS WILL BE
IS NOT YET ENTIRELY CLEAR, HOWEVER. A MEMBER
OF THE PRIME MINISTER'S STAFF HAS EXPRESSED THE VIEW TO US
THAT THE GOVERNMENT SHOULD ADOPT A MIX OF REACTIVATION AND ANTI-
INFLATIONARY ACTIONS UNTIL AFTER ELECTIONS, WHEN A STABILIZATION
PROGRAM MAY BE IN THE CARDS. HE ARGUES THAT A STABILIZATION EFFORT
NOW THAT WOULD INCREASE UNEMPLOYMENT WOULD BE POLITICALLY
DANGEROUS. AT THE SAME TIME, HE RECOGNIZES THAT A MAJOR REACTIVATION
EFFORT WOULD BE UNPRODUCTIVE IN A GENERAL CLIMATE OF LACK OF
CONFIDENCE AND WOULD SOW THE SEEDS OF GREATURE FUTURE PROBLEMS.
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